



UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

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RESOURCES AND ECONOMIC
DEVELOPMENT DIVISION

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The Honorable
The Secretary of Housing and
Urban Development



Dear Mr. Secretary:

In the fall of 1972, GAO, as part of its continuing review of HUD's subsidized housing programs, undertook a survey of the monthly fees paid to mortgagees for servicing subsidized mortgages insured under sections 235 and 236 of the National Housing Act (the Home Ownership Assistance and Rental Assistance programs). We presented the results of our work and suggestions for corrective actions to the former Secretary in a letter dated November 2, 1972.

BACKGROUND

Section 235 of the National Housing Act, as amended (12 U.S.C. 1715z), which was added by section 101(a) of the Housing and Urban Development Act of 1968, authorizes HUD to help low- and moderate-income families become homeowners by providing mortgage insurance and subsidizing portions of the monthly payments due under the mortgages.

Section 236, which was added to the National Housing Act (12 U.S.C. 1715z-1) by section 201 of the Housing and Urban Development Act of 1968, authorizes a rental assistance program under which multifamily rental housing units are provided to low- and moderate-income families. Under section 236 HUD is authorized to insure privately financed mortgage loans for constructing or rehabilitating multifamily housing projects and to pay, on behalf of the mortgagors, the mortgage insurance premiums and the interest on the mortgage loans in excess of 1 percent. Because HUD makes these payments--called interest reduction payments--a basic monthly rent for each housing unit is established at a rate lower than would apply if the project received no Federal assistance.

The Housing and Urban Development Act of 1968 authorizes HUD to reimburse mortgagees for any additional expenses they incur in handling sections 235 and 236 mortgages. The handling fees under the section 235 program amounted to about \$19 million in fiscal year 1973 and will amount to about \$183 million over the life of the program. The handling fees under the section 236 program amounted to about \$150,000 in fiscal year 1973 and will amount to about \$1.5 million over the life of the program.

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BEST DOCUMENT AVAILABLE

SURVEY RESULTS

We primarily evaluated the basis for, and the appropriateness of, the fee paid to reimburse mortgagees for the extra expenses involved in servicing subsidized mortgages. Our work indicated that the fee, as originally established by HUD, was (1) excessive for the work performed by mortgagees handling the section 235 mortgages and (2) unnecessary for mortgagees handling section 236 mortgages.

Section 235

The fee under the section 235 program is to reimburse the mortgagee for necessary bookkeeping and paperwork involved in computing and billing HUD for assistance payments; maintaining the prescribed records in support of the billing; posting HUD's assistance payments in the accounts; and certifying and recertifying the mortgagor's income.

To provide a basis for setting a fee under the section 235 program, HUD held discussions with members of various banking associations. HUD then asked these associations to review a list prepared by HUD which showed the extra work performed by a mortgagee in handling interest assistance payments and to give their best estimate of the cost involved. In August 1968, the Assistant Secretary-Comptroller recommended that the handling fee be set at \$42 per mortgage per annum (\$3.50 per mortgage per month), which was based on the average of the cost estimates submitted by 18 banking institutions which responded to HUD's inquiry. He recommended further that the fee remain at this level until there was enough activity under the subsidized programs to enable HUD to obtain more accurate cost figures.

We concluded that HUD's initial method of establishing the fee may have been appropriate for a short term basis in view of the lack of definitive cost data and the impending startup of the program. Although there had been enough activity under the subsidized programs at the time we reported to the former Secretary in November 1972, HUD had not made any adjustments to establish the fees more closely in line with the actual additional costs incurred by mortgagees in servicing subsidized mortgages.

During our 1972 survey, we interviewed 4 mortgagees, servicing over 5,700 section 235 mortgages, to obtain their estimate of the costs of extra handling expenses for section 235 mortgages. The information provided by three of the mortgagees revealed that their costs were substantially less than the fees HUD paid to them.

For example, three mortgagees in the Seattle, Washington, area estimated their costs of handling section 235 mortgages, and we compared these costs to the fees they received from HUD. Our results follow.

<u>Mortgagee</u>	<u>Number of mortgages</u>	<u>Average monthly cost per mortgage</u>	<u>Estimated annual handling costs</u>	<u>Annual fees collected</u>	<u>Fees in excess of estimated costs</u>
A	587	\$0.42	\$2,928	\$24,660	\$21,732
B	65	0.49	384	2,736	2,352
C	500	0.30	<u>1,776</u>	<u>21,000</u>	<u>19,224</u>
			<u>\$5,088</u>	<u>\$48,396</u>	<u>\$43,308</u>

Officials of the fourth mortgagee, in Washington, D.C., which held 4,588 section 235 mortgages, said that the \$3.50 fee covered their costs, but they were unable to specifically identify the extra handling expenses involved.

Section 236

Under the section 236 program, mortgagees are reimbursed handling fees of \$3.50 per mortgage per month for computing the interest reduction payments, billing HUD for the payments, and posting the payments in the accounts. The project owners, not the mortgagees, are responsible for certifying and recertifying tenant incomes.

HUD furnishes the mortgagees an amortization schedule for each section 236 project mortgage. These schedules show the monthly interest reduction payments over the period of the mortgage. The interest reduction payments under section 236 remain constant throughout the life of the mortgage; therefore, the mortgagees do not have to compute interest reduction payments. HUD could obtain the monthly interest reduction payment amounts from the amortization schedule and pay the mortgagees without the necessity of the mortgagees billing HUD.

We expressed the view in our November 2, 1972, letter that by eliminating the billing procedure for section 236 mortgages, the mortgagees would only have to make simple bookkeeping entries upon receiving the payment which, in our view, would not require a handling cost reimbursement by HUD.

HUD COMMENTS AND SUBSEQUENT ACTIONS

On December 19, 1972, the former Secretary responded to our letter of November 2, 1972, and stated that HUD's frequent changes in requirements imposed on lenders participating in the section 235 program, such as the shift from biannual to annual recertifications of program participants' incomes and the new requirement that mortgagees verify the reported incomes,

had affected the cost of servicing the mortgages and had delayed adjustment of the section 235 handling fee. He also stated that, although recent attempts to obtain cost data from section 235 mortgagees had proved fruitless, HUD had begun a detailed examination to determine the additional servicing costs incurred by the mortgagees.

As for the section 236 handling fee, the former Secretary stated that section 236 mortgages are marketable securities and are bought and sold frequently. Therefore, the only way HUD knows who is holding the mortgages is that the mortgagees provide HUD with consolidated monthly bills for the interest reduction payments relating to all section 236 mortgages in their portfolios each month. However, he agreed that the services provided by section 236 mortgagees were in no way comparable to the additional workload imposed on section 235 mortgagees. He therefore stated that "drastic reductions" in the 236 fee were being considered.

In June 1973 HUD's detailed study of the section 235 handling fee was completed and in November 1973 a report was given to the Assistant Secretary for Housing Management. The study consisted of a review of 51 servicing mortgagees from all geographical areas of the country and covered over 23 percent of the mortgages insured under the program. HUD provided us with a copy of the study report in November 1973. The report recommended that

- the handling fee be reduced from \$3.50 per mortgage per month to not less than \$2.27,
- the handling charge be adjusted at the beginning of each fiscal year to reflect any cost-of-living change during the previous fiscal year,
- a one-time fee of \$5 (which had earlier been suspended) be paid to servicing mortgagees at the time a section 235 mortgage assistance contract is terminated to cover the extra expenses of terminating the contract, and
- there be no additional reimbursement for the cost of obtaining the initial income certifications when originating the mortgage.

Upon receiving the report the Assistant Secretary for Housing Management directed that comments be obtained from the 51 mortgagees before making a decision on implementing the recommendations. As of May 6, 1974, the report with the mortgagees' comments had not been submitted to the Assistant Secretary and action had not been taken on the recommendations.

Since there are about 390,000 insured section 235 mortgages, a savings of over \$2 million could have been realized during the 5 month period, November 1973 through April 1974, had the fee been reduced to \$2.27 when it was recommended.

Also, no action has been taken and no action is planned for reevaluating and reducing the section 236 fee as promised by the former Secretary. HUD officials advised us that priority was being given to revising the section 235 fee because of the greater potential savings involved.

CONCLUSIONS AND RECOMMENDATIONS

We have reviewed the results of the section 235 study and believe that it was well conducted and that the recommendations are well supported. The recommended handling fee represents a reasonable estimate of the costs being incurred by mortgagees. Mortgagees' costs have increased substantially since the time of our limited survey in 1972 due to inflation and additional servicing requirements established by HUD.

Since each month's delay costs the Federal Government about \$400,000, we recommend that the Secretary implement the changes cited in the HUD study report without further delay. We also recommend that the Secretary instruct the Assistant Secretary for Housing Management to immediately initiate the actions necessary to eliminate or adjust the section 236 handling fee.

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We would appreciate receiving your comments on actions planned or taken with regard to the matters discussed in this report. If you would like to discuss these observations in detail, we will be happy to meet with you or members of your staff.

We want to direct your attention to the fact that this report contains recommendations as set forth above. As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions he has taken on our recommendations to the House and Senate Committees on Government Operations not later than 60 days after the date of the report and the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to these committees and to your Inspector General, Assistant Secretary for Housing Management, and Assistant Secretary for Housing Production and Mortgage Credit. Copies are also being sent to the Director, Office of Management and Budget; the House Committee on Banking and Currency; and the Senate Committee on Banking, Housing, and Urban Affairs.

Sincerely yours,

Henry Eschwege

Henry Eschwege
Director